United States Court of Appeals

for the Second Circuit

SUPPLEMENTAL BRIEF

No. 76-4085

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

State of New York, Petitioner, vs. The United States of America and Interstate Commerce Commission, Respondents.	Docket No. 76-4085

B P/S

PETITION FOR REVIEW
OF A DECISION OF THE
INTERSTATE COMMERCE COMMISSION

Brief on Behalf of
S & E Shipping Corp.,
Intervenor in Support of
Petitioner

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This case is upon Petition for Review by the State of New York of the decision of the Interstate Commerce Commission (ICC or Commission) in Docket No. 8899, Unit Train Rates on Wheat, Minn. & Wisc. to Martins Creek, Pa.* S & E Shipping Corp. (S & E or Intervenor) is intervenor in support of such Petition. S & E, based in Cleveland, Ohio, is the largest carrier by water of grain in the domestic commerce on the Great Lakes.

The ultimate issue for review is whether the unit train rates proposed by the Soo Line Railroad Company (Soo) and Erie Lackawanna Railway Company (Erie) for ConAgra, Incorporated, the railroads' supporting shipper, are unfair and competitively destructive of Great Lakes water carrier transportation of grain from Duluth/Superior (Twin Ports) to Buffalo in violation of the National Transportation Policy of the Interstate Commerce Act.

The Commission has decided that such rail rates are compensatory and do not take away the inherent advantage of water carriage. (Brown, MacFarland & Corber).

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* 351 ICC 470 (1976)

With respect to the lake carriers, the Commission makes such finding after applying the rule of ratemaking in section 15a(3) of the Act.

In the view of the Intervenor, the Commission improperly applied such rule of ratemaking because Great Lakes water carriers of bulk commodities, like grain, are exempt from ICC regulation. The Commission instead should have exclusively applied the balance test in the National Transportation Policy and determined that the proposed rail service does in fact destroy the inherent advantages of the water carriers.

Rather than apply this test on the National Transportation Policy, the Commission devoted almost all its energies to measuring distances and applying rates calculated in fractions of a cent and deciding, because the new rail rates are compensatory, that they are legal.

The Commission may be comfortable in these efforts to judge difficult questions involving intermodal carrier competition because numbers and fractions constitute a relatively objective base on which to decide troublesome questions.

But this is concentration on the trees.

The facts require the Commission to regard a much wider base and to make tough value judgments under the National Transportation Policy whether or not to approve the new rates and therefore the new competitive service.

Perhaps if the Commission would tackle these questions head-on and take their chances that their judgment was sound, they would have better luck with the courts in sustaining their decisions, having in mind the analysis in the Journal of Commerce on May 13, 1976, that the "ICC Losing Increasing Number of Court Cases".

Despite proceedings before the ICC lasting over 4 years (even though the Commission skipped the step of an Initial Decision by the Administrative Law Judge to save time) including 1,298 pages of testimony, 39 exhibits and 2,566 pages of pleadings and orders, the important facts are not complex.

The Great Lakes fleet of about 172 vessels under some 15 separate managements in the domestic commerce, moves bulk commodities such as grain, iron ore and coal. These bulk commodities are exempt from ICC regulation. The carriers and shipper instead negotiate rates and service, based essentially on the law of supply and demand. They have been doing business like this for generations - in

our case for over 142 years. As a result, trading patterns, facilities and people have come to depend on the lake carriers and shippers continuing such relationship.

One such fixture is Buffalo.

For as long as can be remembered, grain has been carried by boat from Duluth/Superior to the Buffalo mills, made into flour and sold largely in the eastern markets. Thus, Buffalo is the milling center of the United States.

There is no evidence that anyone is unhappy about this arrangement - not the shippers, not the consumers, not the port interests on the Great Lakes, not the unions or working people, and not the government.

In this setting ConAgra out of Omaha, Nebraska, decided to tap the eastern market.

It must be a dynamic company. Since 1963 it has quadrupled the number of flour mills it operates and it has increased sales almost 6 times.

For reasons that may be guessed at, ConAgra decided not to join the Buffalo millers. Instead, it decided to set up operations in Martins Creek, Pennsylvania. Prudently, the shipper first looked to insure his supply lines. Negotiations with the Soo and Erie produced a unit train rate from Twin

Ports and Twin Cities. This was filed in 1972 but after protest and suspension because, among other things, it was illegal due to a tie-in guarantee arrangement on tonnage, the rate was withdrawn. ConAgra, Soo and Erie then negotiated new, higher rates but no guarantee on tonnage. This rate became effective June 1, 1974.

ConAgra was in business. And it had the best of all worlds.

In the navigation season on the Great Lakes it could, and did, get its grain through Buffalo and then by Erie (the only rail service between the points), or truck, to Martins Creek. The through charge to Martins Creek, boat/rail per CWT was 71.67¢ and 66.67¢ for boat/truck. In the off navigation season it could (but would not because of the advantages of the disputed direct unit train grain rate from Twin Ports to Martins Creek) get its grain through Buffalo (which had a unit train rate from Twin Ports) and then by Erie at 88¢ per CWT.

The unit train rates on wheat direct from Twin Ports and Twin Cities from Martins Creek were set at 72.25¢ for the navigation season and 88¢ in the off season. These rates were specifically set to match the boat/rail rate.*

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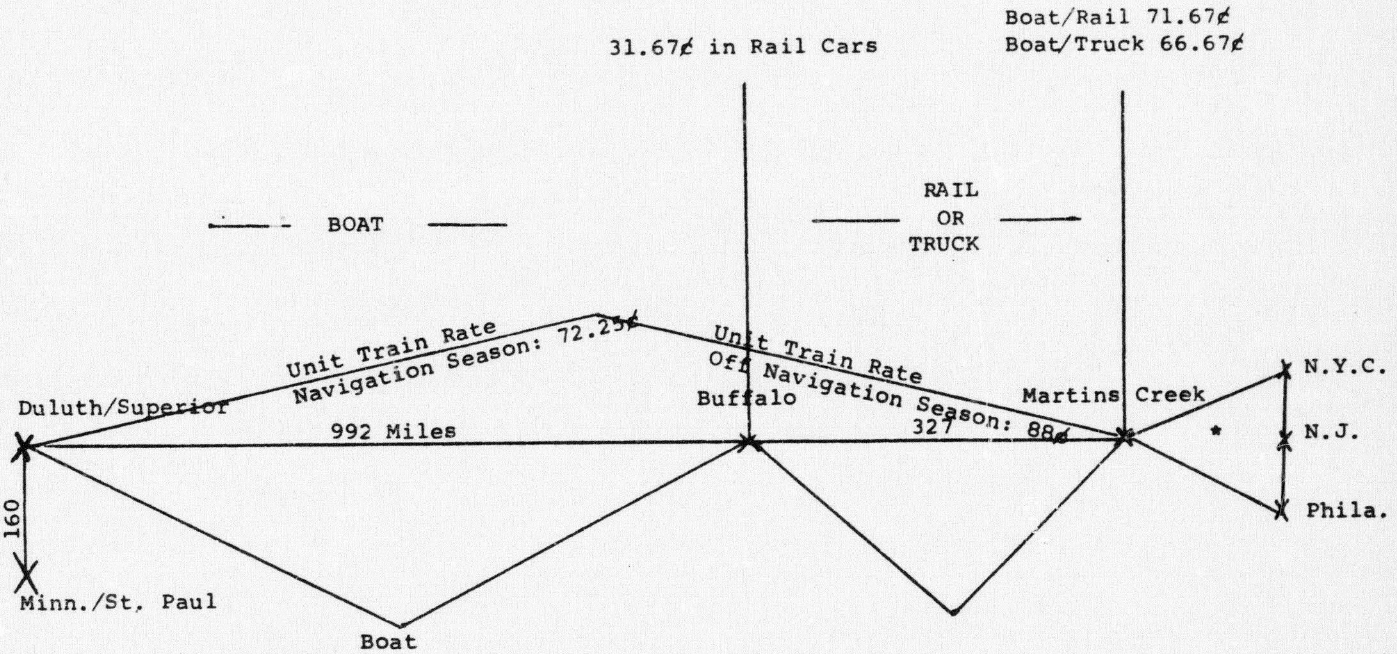
* Some detail on the construction of pertinent rates is contained on the chart, next page.



992 Miles
26.67¢ CWT - Hauling
5. ¢ - Transfer to and from Elevator to Rail Car
31.67¢

Railroad: Erie Only
40¢ - Five Car Published Rate

Truck (unregulated)
35¢

Railroad: Erie
58¢ - Single car rate

*<u>Trucking Radius</u>
Rates vary. Discussed at pages 24-25 Commission Decision.

Shrewdly, ConAgra has not committed to Soo and Erie how much tonnage it will ship under the new unit train rate. No doubt it is keeping its options open pending the court's decision of this appeal. But there can be no doubt that ConAgra will use the direct unit train service. That is what it wanted in the first place. It may keep the railroads guessing as long as possible about using boat/rail service to keep railroad rates as low as possible.

Analyzing these circumstances against protests from the lake carriers, other railroads, millers and port and Seaway interests, the Commission finds no violation of the Interstate Commerce Act.

As for the prosperous Soo, it simply is getting a dividend on the new unit train rate. This is acceptable despite the fact the Soo will get a higher proportion of the through unit rate from Twin Ports and Twin Cities to Martins Creek than it does on the through unit rate from those places to Buffalo, even though in each case it serves only to Chicago.

The Erie is more of a problem.

Repeated references to Erie's financial plight and its status in bankruptcy makes the Commission seem like a cheerleader.

Working as hard as it did, with dizzying figures, reliance on the capital of Soo to compensate for Erie's rate base and on various assumptions to justify the results, it takes a hard heart not to accept the Commission's findings that the rate to Erie is compensatory.

Even so, the Commission is not so sure of its findings. In its final observation on Erie's position on these rates it refers to the broad public interest in preserving a viable network of railroad service.

On these matters one is reminded of the public debate and national policy concerning New York City, Lockheed, Penn Central, etc.

But again, whether such rates are compensatory is not the crux of the matter. The problem is the effect of those rates on other interested parties.

The Soo/Erie hotshot rate from the Twin Ports to Martins Creek puts ConAgra all but knocking on the doors of New York City, Philadelphia and New Jersey markets for a rate of 72.25¢. Those who ship by boat to Buffalo and who, for discussion purposes, wish to send their grain (rather than flour) closer to eastern seaboard markets for milling cannot compete. To a charge of 31.67¢, in rail cars at Buffalo, must be added 58¢ for a total of about 90¢ in the big city

market because Erie does not offer a unit train rate from Buffalo.

On these facts, ConAgra with the help of the Soo/Erie rate is not only tapping the market, it is about to crack it.

And this is the essence of our disagreement with the Commission. The Commission has erroneously and grievously construed the rule of ratemaking in section 15a of the Act, in particular section 15a(3). This section provides that in any proceeding involving competition between carriers of different modes, the Commission shall consider the effect of the rate on the proponent and that the rate of the proponent shall not be held to a particular level to protect the traffic of another mode of transportation, giving due consideration to the objectives of the National Transportation Policy.

In deciding that the proposed rate does not violate this rule, the Commission does acknowledge and accept lake carriers' information that sets the water rate between Twin Ports and Buffalo at 16¢ a bushel or 26.67¢ CWT. But the Commission then scolds the lake carriers for not providing evidence as to the "character" of the operations conducted by its members and for not providing information on "cost" of service.

Thus, in this intermodal rate proceeding (for which the Commission says it "may not substitute assumption for hard evidence"), and after repeatedly referring to lake carriers as "unregulated" carriers - as though we were outlaws - the Commission concluded:

> "Its failure in this regard when considered in light of other facts of record, leads us to conclude that the proposal does not take away the inherent advantages of water carriage."

The Commission's finding is a wipe-out of lake carriers.

And for what?

Because we did not present nice, detailed, explicit information on operations and costs, like the carriers which the ICC regulates.

But we are unregulated. We are exempt. That is the law. And the Congress has kept us exempt from ICC regulation, despite the fact that the ICC, repeatedly, since at least 1954 has urged the Congress in formal legislative recommendations to put us under their economic thumb. Not only that, the Congress went the other direction from the Commission's recommendations to regulate bulk water carriers. In 1973, the Congress <u>extended</u> the kinds and number of exempt cargoes that may be carried by "unregulated" water carriers.

Hopefully, the Commission is not trying to achieve by its decision in this case what it has not been able to persuade the Congress to do.

There cannot be doubt how and what kind of operations are conducted by exempt Great Lakes water carriers. Such carriers have been around for many years hauling the same cargoes, to the same places, for the same shippers, almost without change. The law of supply and demand still works - at least with respect to Great Lakes shipping.

As for section 15a(3), this was passed in the Transportation Act of 1958 at a time when railroads' fortunes were ebbing and motor carrier fortunes were rising. The legislative history to this Act makes clear that the Congress wanted to give the railroads a better break in their competition with trucks on minimum rate policy. Thus, the provision was added that rates shall not be held up to a particular level to protect the traffic of another mode of transportation. But the Congress knew that such rate policy could destroy competition, if the strong mode started a rate war.

It therefore added the safety valve that such new freedom on minimum rate policy had to be considered against the objectives of the National Transportation Policy. Among these objectives is impartial regulation of all modes of

transportation "so administered as to recognize and preserve the inherent advantages of each".

Clearly it is not easy to balance questions of rate policy against the need to preserve the inherent advantages of each mode in our national transportation system.

But this is the Commission's legislative mandate.

Difficult as it is to weigh these elements, it must be done with such guidance as the courts have provided both before and since the Transportation Act of 1958, including decisions which have been favorable to the water carrier view of how this scale is to be balanced, of which there have been many at the U. S. Supreme Court and other federal courts, including a most recent decision involving the <u>Lake Carriers Association vs. the United States and ICC</u>.

The biggest reason the Commission shied away from making tough decisions on the required balance between rate and the place of water carriers in our national transportation system is its failure to see that that policy is dynamic, not static.

Certainly the Commission saw in this dispute the financial failure of the Erie and the hope for its survival under the Rail Reorganization Act. But the Commission did not consider at all the positive action taken by the Congress, in this decade, to upgrade the Great Lakes fleet.

In the Merchant Marine Act, 1970, which was passed almost unanimously, the Congress for the first time extended very substantial tax and other financial aid to rehabilitate the domestic Great Lakes fleet. Also, the Congress officially designated the Great Lakes as the Fourth Seacoast of the United States. Since that time, additional legislation has been passed for the Corps of Engineers to extend the navigation season on the lakes and to earmark specific percentages of government aid to upgrade Great Lakes shipping.

As a result, more new bulk carriers have been built for domestic Great Lakes service since the 1970 Act than in the previous 35 years combined. And for the grain trades, S & E has a specific contract with the United States for new ship construction.

Surely this progress in Great Lakes transportation, which was specifically encouraged by the Congress, should not be jeopardized as to the grain trade, which is a vital part of the total commerce of the Great Lakes, by a rail rate for a new aggressive miller who wants to do things differently.

Low cost, adequate service in the carriage of bulk grain has been provided by lake carriers for generations in the domestic commerce. Equipment, facilities and people are in place on the Great Lakes to serve this trade.

An exotic rail rate to capture a substantial portion - and maybe all, in due course - of an established market developed by another mode of transportation should not be permitted under the National Transportation Policy which is intended to preserve the inherent advantages of each mode of transportation.

Finally in asking the Court to find that the proposed rail rates are unlawful under the National Transportation Policy, Intervenor is mindful that there are case decisions to guide the court. We have, accordingly, examined pertinent case decisions both for and against us - and reported both.

Our ultimate view about these decisions is that the Court has reversed the Commission sufficient times as to leave open the bet how each case will come out.

But we do recognize the difficulty for the Commission in trying to apply the rule of ratemaking on the one hand, and, on the other, to preserve the inherent advantages of each mode of transportation in intermodal competition. The Commission however seems not yet to understand, or apply, that there are substantial differences in how the case is to be considered, depending on whether the Commission has before it opposing sides in which each is strictly regulated and highly structured to operate

under the Commission's regulations; or, one side is strictly regulated and the other is quasi-regulated (depending for instance on commodities carried); or, as in this case, strictly regulated vs. unregulated, or exempt carriers.

All too often it appeared that the Commission approached these cases as though both sides were strictly regulated in which it considered fully distributed costs, short-run-out-of-pocket cost, long-run-out-of-pocket cost, and long-run-marginal cost.

But, in our view, the instant case is a somewhat apples and oranges case that the Commission - and now the Court - must decide.

The case is simply one of raw power by a stronger mode musceling out an established carrier of another mode.

This is unfair; it is discriminatory; it is destructive competition within the formerly applicable standards of the Sherman Act and under present requirements of the National Transportation Policy.

The proposed rail rates should therefore be found to be unlawful.

Part II

Arguments

The Interstate Commerce Commission is Philosophically and Fundamentally Opposed to Water Carriers Being Exempt from Regulation by the ICC in the Carriage of Dry-Bulk Commodities

Other Statutes Which ICC Must Consider in Implementing National Transportation Policy

Section 15a(3), Rule of Rate-Making Does Not Apply to Exempt Water Carriers

On the Facts the Proposed Rail Rates Are Destructive of Water Carrier Competition

The Interstate Commerce Commission is Philosophically and Fundamentally Opposed to Water Carriers Being Exempt From Regulation By the ICC in the Carriage of Dry-Bulk Commodities

Since 1954, the Interstate Commerce Commission has repeatedly recommended to the Congress that it repeal the exemption for bulk cargo water carriers under Section 303(b) of the Act. (49 U.S.C. §903(b)).

In its 68th annual report to the Congress in 1954 the ICC stated:

> ". . . the exemption adversely affects the public interest in stable, reasonable and properly related rates and makes effective regulation of water transportation impossible . . . " (p. 20).

In its 69th annual report in 1955, the ICC made the same statement again and added that it had favored bills which would remove the bulk exemption for water carriers (p.18).

In 1958 in its 72nd annual report the ICC expressly recommended the repeal of Section 303(b), giving the following reasons for its recommendation:

> "Because of the various exemptions in part III of the act, the greater percentage of all domestic for-hire water transportation is free from economic regulation by the Commission. The most significant of these is the so-called bulk commodity exemption.

This exemption puts the regulated carriers to a distinct competitive disadvantage and results in discrimination between shippers and localities. The public interest in stable, reasonable, and properly regulated rates cannot find expression in the complete absence of control of such a large segment of the bulk-carrying trade.

Enactment of this recommended amendment would go a long way toward correcting this undesirable situation and would also constitute an important step toward equality of treatment of carriers of the various modes." (p. 142).

The Commission again made this recommendation to repeal bulk exemptions in later reports to the Congress, complaining that no hearings had been scheduled on their proposals. (ICC 1961 Annual Report, p. 192).

The reason for the Commission's determined opposition against the exempt status of dry bulk water carriers may be found in the fundamental philosophy of the Commission that to exercise its responsibilities under the Act it had to have equal control of all carriers subject to its jurisdiction by regulation of prices, which were dependent on cost of service.

The Commission's fundamental opposition to the bulk cargo exemption was not limited to water carriers. Part II of the Act exempts from economic regulation motor vehicles carrying agricultural and horticultural commodities and fish. (§203(b)(6); 49 U.S.C., 303(b)(6)). There are no similar exemptions under Part I of the Act regulating the railroads.

The Motor Carrier Act of 1935 was passed with two agricultural exemptions covering both farm products and farm supplies and an agricultural commodities exemption.

The Interstate Commerce Commission almost as soon as these several exemptions were enacted into law has advocated a restriction on the exemptions in the form of limiting its application from the movement of farm to first market. The ICC or its legislative committees made such proposals to Congress in 1939, 1940, twice in 1952, 1955, 1956, 1957, but the proposed amendments were never adopted by the Congress. In fact, during this period all amendments which were enacted adopted the contrary view and were expressly intended to broaden the exemptions. The amendment to Section 203(b)(6) of the Act under the Transportation Act of 1958 was the first enactment by Congress to somewhat narrow the exemption.*

From enactment of the Transportation Act of 1940 which made water carriers subject to the jurisdiction of the ICC and enactment of the Motor Carrier Act of 1935 which made

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* It was also in the Transportation Act of 1958 that the Congress added the rule of rate-making under §15a(3), which will be discussed hereafter on the matter of rate-making in intercarrier competition.

motor carriers subject to the jurisdiction of the Commission, the ICC had adhered to the principle that exemptions in remedial legislation are to be restrictively construed in order not to impinge upon the effectiveness of the Act itself as a whole. However, according to a report on National Transportation Policy by a special study group prepared for the Committee on Interstate and Foreign Commerce, United States Senate (Senate Report No. 445 , 87th Congress, 1st Session, January 3, 1961, p. 134): "the courts have almost as consistently down through the years adhered to a contrary interpretation of agricultural exemptions."

The Interstate Commerce Commission seemed to agree that the courts had interpreted the provision on agricultural exemptions consistently contrary to the Commission. Its Chairman testified before the Surface Transportation Subcommittee of the Senate on March 28, 1958, addressing himself to exemptions in the Interstate Commerce Act.
He said:

> "Like the railroads and others who have testified, we are of the view that agricultural exemptions have been extended by judicial decision greatly beyond what the Congress intended. The Commission has for some time realized that this progressive broadening of the list of exempt commodities would have a ruinous effect on the entire structure of regulated carriage."

While there was some arresting of the "progressive broadening of the list of exempt commodities" under the Transportation Act of 1958, it is significant that for more than twenty years, with respect to the agricultural exemption for motor carriers, that the Congress and the courts not only did not accept the Commission's recommendations to repeal and limit such exemptions, but the Congress and the courts acted directly contrary to the recommendations of the Commission. Thus, the law today with respect to agricultural exemptions is much the same as it was when first enacted; i.e., those exemptions which are repugnant to the Commission still apply.

More significantly, the bulk commodity exemptions for water carriers under Part III not only apply as first enacted but have been extended over, it might be said, the proverbial dead body of the ICC.

The bulk exemption of water carriers under Section 303(b), Transportation Act of 1940, provided that the exemption should be limited to not more than three commodities in bulk on one vessel. This was the provision the Commission repeatedly and doggedly asked the Congress to repeal because of incompatibility, in the Commission's view, of economic regulation of competing carriers by different modes.

As indicated, the Congress gave a deaf ear to these recommendations by the Commission. In fact, the Congress went the other way.

In 1973, in P.L. 93-201, the Congress eliminated the limitation on the exemption to three bulk commodities; instead, it made the exemption "apply to the transportation by a water carrier of commodities in bulk". Senate Report No. 93-513, to accompany S.2267 on this legislation made clear that the purpose of the bill was to remove outmoded restrictions upon qualified exemptions contained in Section 303(b) of the Interstate Commerce Act "which stand as a bar to the realization of greater efficiency of operations. . .". The Congress therefore adopted the recommendation of the Secretary of Transportation* under P.L. 91-590, which was to make a comprehensive study of the system of economic regulation of dry bulk commodity transportation by water carriers. The study group concluded "that the three commodity restriction and the no-mixing rule no longer serve any relevant or beneficial purpose for

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* To whom the assignment was directed, and not the Interstate Commerce Commission.

the water carrier industry or the shipping and consuming public".

Although all witnesses appearing before the Committee supported S.2267 and its purpose to eliminate the no-mixing and three commodity restriction on the Section 303(b) exemption, following were the views of the Interstate Commerce Commission on this subject.

As to the study eventually authorized by P.L. 91-590, the Chairman of the Interstate Commerce Commission testified at hearings before the Subcommittee on Transportation and Aeronautics of the Committee on Interstate and Foreign Commerce, House of Representatives, 91st Congress, 1st Session on bills to amend Section 303(b) of the Act, Serial No. 9116, that:

> "Since the railroads, which are the water carriers' principal competitors for bulk commodity traffic, have always been subject to full economic regulation by the Commission, we have recommended on a number of occasions that the exemption provided by section 303(b) be repealed in its entirety in the interest of providing equality of competitive opportunity and regulatory treatment among the several modes of transportation. No action has ever been taken on these proposals by Congress. We continue to believe that the continuance of the present exemption is neither conducive to fair and effective regulation nor to effectuation of the goals of the national transportation policy. At the same time, we also recognize that there is substantial congressional sentiment for the retention of this exemption. In these circumstances, the present situation is inequitable

> and unfair to substantial segments of the water carrier industry."

As to P.L. 93-201 which <u>extended</u> bulk commodity exemptions, the ICC, seeing the handwriting on the wall in favor of the legislation, finally decided that the mixing rule and the three commodity restriction should not be opposed as a separate issue on bulk exemptions, but the Commission did not change its long-held position against such exemptions. The Commission urged the Congress to include its suggested amendment to require:

> "the filing and publication of rates and charges for exempt dry bulk commodity traffic." (Letter, George M. Stafford, Chairman, ICC, Letter of September 24, 1973, to Chairman, Committee on Commerce appended to Senate Report No. 93-513).

Thus, up to and including the pendancy of the instant case, ICC Docket No. 8899 on Unit Train Rates on Wheat Minn. & Wisc. to Martins Creek, Pa., the Commission has unalterably and strongly opposed the fact that Great Lakes carriers are exempt from ICC regulation when they carry dry-bulk commodities like grain, which is the subject of the instant appeal. So far, the Congress and the courts have not seen the problem the same as the Commission. So far, the Congress and the courts have consciously, repeatedly and affirmatively preserved the status of such water carriers as exempt from ICC regulation.

It may be wondered what effect the Commission's frustration in not being able to absorb exempt water carriers under its regulatory control had on the Commission's decision in the unit train wheat case, particularly as the Commission in its decision on July 18, 1974, repeatedly refers to the Great Lakes carriers as "unregulated" carriers - as though they were outlaws.

Other Statutes Which Interstate Commerce Commission Must Consider in Implementing National Transportation Policy

The "National Transportation Policy" is stated in the preamble to the Interstate Commerce Act (49 U.S.C. preceeding Section 1). It requires, in brief, that the Commission provide fair and impartial regulation of all modes of transportation subject to the Interstate Commerce Act "so administered as to recognize and preserve the inherent advantages" of each mode of transportation.

Clearly, the ICC has a difficult job to balance the needs and requirements of the different carriers in competing modes to serve the public.

Difficult as may be the job in attaining the balanced transportation system prescribed in the National Transportation Policy under the Interstate Commerce Act, the Commission is also burdened to know and apply other statutes which round out national transportation policy. In assessing the relative requirements to develop a sound national transportation system, for example, in the water carrier as compared to the railroad mode, the Commission is safe in looking to the Interstate Commerce Act to find congressional expression of policy towards the railroads because all statutory law involving the economic regulation of the railroads may be found essentially in the Interstate Commerce Act, as amended. But this is not true with respect to national policy on water carriers.

Some of our national policy with respect to water transportation has been included in the Interstate Commerce Act other than in the National Transportation Policy. 49 U.S.C. 142, for example, declares it to be the policy of Congress to promote, encourage and develop water transportation services and facilities in connection with the commerce of the United States and to foster and preserve in full vigor both rail and water transportation. And,

the Hoch-Smith Resolution (49 U.S.C. 3(1a)) directs the Commission to effect lawful charges in the rate structure to promote movement of agricultural products at the lowest possible lawful rates compatible with adequate service.

But there is other legislation, not in the Interstate Commerce Act, which elaborates national policy with respect to domestic water transportation and which the Commission is obligated to consider in weighing the scales between railroads and domestic water carriers in a competitive relationship. Such additional legislation includes the Merchant Marine Act, 1936, as amended, 46 U.S.C. 1101, in which it is the declared policy of the United States for purposes of national defense and domestic commerce to have a merchant marine "sufficient to carry its domestic water-borne commerce".

And, the ICC must regard legislation enacted to promote such domestic water-borne commerce, such as the Merchant Marine Act, 1970 (Public Law 91-469) which officially designated the Great Lakes as the "Fourth Seacoast of the United States" and which, for the first time, extended to the Great Lakes domestic fleet considerable tax and other

financial assistance in rehabilitating the aging Great Lakes fleet.*

The Commission cannot disregard the results of this legislation to rehabilitate the Great Lakes fleet which has resulted in the building of more bulk carriers since the Merchant Marine Act, 1970 for domestic waterborne commerce on the Great Lakes than in the previous 35 years combined. Nor can the Commission overlook the legislative history supporting the Merchant Marine Act, 1970 which instructed the head of the Maritime Administration to undertake research projects aimed at determining the adverse effect on Great Lakes shipping from existing railroad rate

* Including S & E Shipping Corp., intervenor in this Petition for Review, which has a contractual commitment with the United States to build additional bulk grain carriers for the domestic commerce under the Capital Construction Fund provisions of Title VI of the Merchant Marine Act, 1970, 46 U.S.C. 1177.

structures. (Senate Report No. 91-1080, 91st Cong. 2d Sess., p. 129.)*

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* Pursuant to this mandate, a research group commissioned by the Maritime Administration referring to proceedings before the ICC in adjudicating or enforcing the resoluting of disputes in rail-water competition found:

> "Vague terms exist in the Interstate Commerce Act in the National Transportation Policy without any specific reference to the Great Lakes apart from inland waterways thus appearing to deny its status which has now been made official in foreign trade by the Maritime Act of 1970. This makes both regulation and enforcement difficult."

And, with respect to railroads overwhelming water carriers and legal proceedings before the ICC, the research group found:

> "Procedural steps in adjudication of modal disputes tend to favor the more highly structured and capitalized rail carriers. Their permanent legal staffs are more capable of withstanding the extreme time and monetary expenses associated with adjudication within the ICC."

And, with respect to remedies if water carriers should win:

> "It is all the more frustrating to fight a lengthy case through the ICC...which tends to be a hollow victory because the traffic opportunity may be gone, much money has been expended and the precedent will not be used by the ICC to avoid another similar situation." (_Relationship Inland Transportation Economics to Great Lakes Volume, U.S. Department of Commerce, Maritime Administration Contract No. 1-35492, October, 1971, at page S-4_.)

In addition to the very substantial shipbuilding program authorized by the Merchant Marine Act, 1970 the Congress has passed legislation (Public Law 91-611) requiring the Corps of Engineers to extend the navigation season on the lakes; and, additional legislation has been passed to earmark specific percentages of government aid to upgrade the Great Lakes fleet. (Public Law 94-127, concerning the Maritime authorization for fiscal year 1976.)

As the Congress passed the Merchant Marine Act, 1970 almost unanimously (3 dissenting roll-call votes), the ICC should be aware of the strong commitment by the Congress not only to preserve but to upgrade the Great Lakes fleet for purposes of domestic commerce and national defense.

Intervenor concedes that the Congress in recent years has passed legislation to help financially strapped railroads, as in the Rail Reorganization Act. And we agree that the railroads' need for help is a consideration in the public policy and public interest questions implicit in the instant case. But surely there is a compelling difference between the emergency action of the Congress to save (from nationalization) the bankrupt railroads and the steady, deliberate development of law to sustain domestic water transportation as a key segment of our national transportation system - under private enterprise, which in the case of the Great

Lakes carriers operates on competitive principles of the law of supply and demand, satisfying shipper, industry and consumer needs, without need for economic regulation by a federal agency. Aside from the fact the latest legislation to save the railroads is not applicable to this case as having been enacted after the issues were joined, no sensible judgment can be made that such legislation was intended to undermine the positive program by Congress to build up and rely on the nation's water carriers to "carry its domestic water-born commerce."

Section 15a(3), Rule of Rate-Making <u>Does Not Apply to Exempt Water Carriers</u>

The essence of the differences between S & E and the Commission in this Petition for Review is that the Commission considered the exempt Great Lakes bulk carriers to be subject to the rule of rate-making as prescribed in section 15a(3) of the Transportation Act of 1958; whereas, in fact, such lake carriers, being exempt from ICC regulation, are not

subject to such rule of rate-making, leaving only the National Transportation Policy as it existed prior to the Transportation Act of 1958 as the test by which the Commission was to judge whether the unit train rate on wheat from Twin Ports and Twin Cities to Martins Creek, Pa. constituted destructive competition of the lake carriers who have established, over several generations, shipping service by water transportation from Twin Ports of almost all grain moving to the eastern market through Buffalo, which had developed into the milling center of the United States, much as Pittsburgh for steel, Detroit for automobiles, New York City as the financial center of the country, etc.

It is of course Intervenor's contention that under this test the Commission should have found such rates did constitute destructive competition.

But the Commission decided that the rates were lawful, Docket No. 8899, July 18, 1974, 346 ICC 814.

In reaching this decision the Commission concluded that the protests by the Great Lakes carriers against the proposed unit train rate "impels consideration of the rule of rate-making set forth in section 15a of the Act", Unit Train Rates on Wheat, Minn. & Wisc. to Martins Creek, Pa., 346 ICC, 850 (1974).

In considering this "issue" the Commission first noted the argument by lake carriers against the proposed unit train rate.

That argument, in essence, is that the Erie does not hold out rates or unit train service on wheat interchanged at Buffalo with lake carriers at levels comparable, distance considered, to the proposed rates. Similarly, Erie does not offer to publish rates or unit train service on flour milled at Buffalo and shipped to the New York City and Philadelphia areas at levels comparable to the proposed basis. Also, the lake carriers argued that the present lake vessel rate from Twin Ports to Buffalo, including the cost of transferral to rail cars, is about 35 cents. The rate on flour from Buffalo to the New York and Philadelphia markets is 58 cents producing a through water-rail charge of 93 cents. To meet the competition posed by the proposed 72.25 cents rate, the lake carriers would have to reduce the water carriers cost from 35 cents to 14.25 cents or about 59 percent. The rail distance from Twin Ports to Martins Creek is about 1,379 miles while the distance from Buffalo to Martins Creek is about 340 miles. Thus, the Erie and Soo Railroads are transporting wheat an additional 1,039 miles for only 14.25 cents more than they obtain for handling flour from Buffalo to the eastern market. Stated otherwise, Erie transports flour

340 miles at a charge which is about 80 percent of the proposed 72.25 cents rate which applies for a distance of about 1,039 miles. The existing single car rate on wheat from Twin Ports to Martins Creek is $1.05 or 32.75 cents higher than the proposed 72.25 cents rate. The lake carriers therefore concluded that a reduction of this magnitude can only be classed as predatory. Further, the lake carriers concluded that the inability of the lake carriers to compete with the proposed rate is not due to the inherent efficiency of the all-rail route, but rather to Erie's discriminatory failure to provide unit train rates and service, distance considered from Buffalo to Martins Creek, New York City and Philadelphia. According to the lake carriers, Erie is using its monopoly control of the area east of Buffalo to force grain traffic off the Great Lakes and on to the "all-rail" route through the device of keeping the ex-lake rates out of Buffalo at such a high level as to preclude use of the lake-rail route.

After reviewing these arguments by the lake carriers under the rule of rate-making set forth in section 15a of the Act, the Commission concluded that the ultimate issue in the case between the lake carriers and the railroads

"is whether the proposed rates deprive protestants' members of their inherent advantage". 346 ICC at 850.

Although the Commission notes that the lake carriers introduced evidence to show that wheat is transported by vessel at 16 cents a bushel or 26.67 cents per CWT for the 992 miles from Twin Ports to Buffalo, the Commission notes that "the record does not disclose protestant's cost of providing a service from Twin Ports to Buffalo". And, "in an intermodal rate proceeding the Commission may not substitute assumption for hard evidence". 346 ICC at 850. In addition, the Commission emphasized that the lake carriers presented little evidence as to the "character" of its operations. The Commission concluded: "Its failure in this regard when considered in light of the other facts of record leads us to conclude that the proposal does not take away the inherent advantage of water carriers." 346 ICC at 850.

The Commission commits a fundamental and fatal error in refusing to consider lake carriers' argument that the proposed unit train rate does constitute destructive competition simply because lake carriers' failed to provide cost information and to describe the character of its operations.

Since the Commission relies on the rule of rate-making, section 15a(3), for its determination that it cannot sustain

the argument of the lake carriers on inherent advantage, it is instructive to review the development of section 15a(3) in the Transportation Act of 1958 as it applies - or does not apply - to Part III water carriers.

Legislation extending comprehensive regulation to water carriers competing with railroad and motor carriers was not enacted until 1940. The Senate report accompanying the bill which became the Transportation Act of 1940 stated there was a plethora of transportation facilities. It also observed there was no equality of treatment when the railroads and motor vehicles are strictly regulated and other forms are regulated to a much lesser extent. To equalize competitors and put them on a common footing from a regulation standpoint, legislation extending regulation was proposed. This was not for the purpose of favoring one form of transportation over another or seeking to put any form of transportation out of business, but simply to put them all on a common basis or starting point in their sharp struggle for business. (U. S. Congress, Senate Report 433, 76th Congress, 1st Session, Part 1, pages 2 and 3.)

The Transportation Act of 1940 made no essential change in Sec. 15a of the Interstate Commerce Act other

than to apply it to all carriers <u>regulated</u> under the Act. As has already been described, water carriers transporting bulk commodities were exempt from regulation by the ICC under this very Act, therefore, as to rate competition between the exempt water carriers and the railroads, the common footing from a regulation standpoint did not apply.

Similarly, in the report accompanying the Transportation Act of 1958, the Senate Committee on Interstate and Foreign Commerce stated that each form of transportation should have the opportunity to make rates reflecting the different inherent advantages each has to offer so that the public may exercise its choice, cost and service both considered.

The Senate report stressed its objective to be the encouragement of competition without permitting "unfair or destructive competitive practices" as contemplated by the Declaration of National Transportation Policy. The Committee stated that the principal emphasis, but not the exclusive emphasis, in a competitive rate-making proceeding involving different modes of transportation would be on the conditions surrounding the movement of the traffic by the mode to which the rate applies. (Senate Report No. 1647 June 3, 1958 to accompany S.3778.)

The House Committee on Interstate and Foreign Commerce in its report on the bill leading to the Transportation Act of 1958 after noting the changes in distribution of inter-city freight traffic in the United States (mostly decreasing tonnage by railroad and increasing tonnage by motor carriers) described the bills then under consideration as the "three-shall-not-rule" because they declared in determining what is less than a reasonable minimum rate, that the Commission:

1. Shall not consider the effect of the rate on the traffic of other carriers.

2. Shall not consider the relation of the rate to the rate of any other carrier.

3. Shall not consider whether the rate is lower than necessary to meet the competition of other carriers.

The railroads vigorously supported these provisions. The motor and water carriers vigorously opposed these provisions.

The "three-shall-not-rule" did not become law.

The Secretary of Commerce (who then had responsibility for national transportation policy in the executive departments) expressed the view that:

> "We have considered the three-shall-not-rule and feel that it goes too far."

While agreeing that there should be greater competition among carriers in rate-making he said, "unfair or destructive competition should be prevented by some sort of rule of reason similar to that in the Sherman Act". (emphasis added)

The Committee stated that each mode of transportation shall have opportunity to make rates reflecting the different inherent advantages each has to offer so that the public may exercise its choice among them, cost and service considered, in the light of the kind of transportation desired.

The Committee concluded: "and the National Transportation Policy is clear that such ratemaking shall be regulated by the Commission to prevent unfair or destructive practices on the part of any carrier or group of carriers."

After noting that the ICC had not been consistent previously in allowing one or another in transportation to assert its inherent advantages in the making of rates, the Committee stated it "believes that the Commission should consistently follow the principle of allowing each mode of transportation to assert its inherent advantages whether they be cost or service, giving due consideration to the objectives of the National Transportation Policy in the Interstate Commerce Act". (House Report No. 1922, June 18, 1958, to accompany H.R. 12832.)

In a word, the legislative history of the Transportation Act of 1958 with respect to the rule of rate-making was "compromise".

Carriers (and the Congress had the railroads in mind) could reduce rates and the Commission was obliged to consider primarily, but not exclusively, the effect of that rate on the railroad proposing it, but such rates were not to be unfair or cause destructive competition and the test by which the Commission was to balance the effect of the rate on the inherent advantages of the competitive mode of transportation was a "rule of reason", under concepts similar to the Sherman Act.

It may be said, therefore, that the 1958 amendment did little to clear the uncertainty of the then existing law on rate policy. In fact, it may be argued that the meaning of the minimum rate policy had become more confused since the passage of the Transportation Act of 1958. (Report on National Transportation Policy prepared for the Committee on Interstate and Foreign Commerce. U. S. Senate, Senate Report No. 445, January 3, 1961, p. 400.)

Most important, the Transportation Act of 1958 did nothing to put exempt water carriers under economic regulation

of the Interstate Commerce Commission.* Therefore, there can be no obligation on such exempt water carriers to provide the nice, detailed, explicit cost information which the Commission looks for in rate-making proceedings involving competitive modes. Rather, the Commission was left to its judgment on the relative advantages and disadvantages to the shipper, the carriers and the public interest at large, in disputes between competing modes on the effect of a proposed rate.

On the Facts the Proposed Rail Rates are Destructive of Water Carrier Competition

The Commission has no license to eliminate the Great Lakes carriers in this proceeding because they did not describe the "character" of their operations or provide detailed "cost" information.

The Commission instead should have made the judgment on the lawfulness of the proposed rate by considering all

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* Recognized by the Supreme Court in American Commercial Lines v. Louisville and Nashville Railroad Co., 392 U.S. 571 (1968) at 593, and discussed further, later in this report.

the facts and circumstances in the proceeding, including not only the revenue needs of the railroads (for which the Commission gave particular attention to the Erie in its bankrupt condition, indicating thereby some regard for the public interest in these proceedings) but to the effect on milling interests in Buffalo, and port interests throughout the lakes, and working people in all these places and on the adverse effect on the lake carriers, as ConAgra, Soo and Erie teamed up to provide a new transportation service which was most likely to be profitable because it was new business and a direct diversion of traffic from a stable market in a competing mode.

And, in this respect, the Commission was unjustified in speculating, as it did, in its decision, 346 ICC at 851, that there is no warrant for concluding the railroad rate is a destructive competitive practice because all that the railroads would divert from the lake carriers under this proposal was 7% of the wheat which could be considered as moving to or via Buffalo. Such judgment was speculative in the extreme and most assuredly wrong in its estimate.

If ConAgra, Soo and Erie are successful in establishing an all-year, unit train rate from Twin Ports and Twin Cities

to a mill at the doorstep of the large eastern market, in a situation where there is no chance of competitive transportation east of Buffalo, there should be little doubt that millers presently concentrated in Buffalo will change shipping and marketing patterns to compete with ConAgra by relocating grain storage or milling facilities to take advantage of such all-weather unit-train rate, to the disadvantage (and most likely destruction) of the grain carrying shipping industry on the Great Lakes which has existed for more than 142 years.

Part III

Analysis of Applicable Court and Commission Decisions

-- Introductory Note

The Courts Have Uniformly Required that the Commission Recognize and Preserve the Inherent Advantages of Each Mode of Transportation, Unregulated as Well as Regulated

It is Error to Hold that Exempt Lake Carriers are Not Entitled to Protection of Section 3(4) and are Not a Connecting Carrier Within the Meaning of the Section

Applicable Court and Commission Decisions

Introductory Note:

Intervenor appears before the Bench in the instant case as an advocate. The analysis of the cases to follow, however, do not all support Intervenor's position. Indeed, we would be surprised if the opposition did not cite some of them against us. But we take our chances in giving at least the flavor of all pertinent cases, both good and bad, because our overall point has been that there is an apples and oranges effect in requiring the ICC to apply the rule of rate-making on the one hand and on the other to preserve the inherent advantages of each mode of transportation in intermodal competition; thus, the Congress has effectively charged the Commission with making judgment decisions based in most part on the comparative advantages and disadvantages to the public of allowing or denying a proposed competing rate, recognizing of course that there is law and precedent to guide the Commission.

Thus, in approaching these rate-making cases the Commission has been obliged to consider whether it had before it opposing sides in which each was strictly regulated and highly structured to operate under the Commission's regulation; or that one side was strictly regulated and the other quasi-regulated (depending, for instance, on commodities carried); or, as in this case, strictly regulated vs. unregulated, or exempt carriers. The kind of case which the Commission had governed very much the emphasis it was to give on considerations of value of service, quality or service, fully distributed cost, short-run-out-of-pocket cost, long-run-out-of-pocket cost and long-run marginal cost.

And the cases discussed immediately hereafter reflect the dilemma caused by these different and sometimes irreconcilable requirements. Decisions vary - both at the Commission and Court level - depending, it seems, on what was considered to be the more demanding requirement at the time; i.e., price stability, the need for

waking a settled, lethargic carrier by the introduction of new competition, national defense considerations, etc.

Returning to our role as advocate, it is urged that attention be given to the conclusion of the Supreme Court in the Ingot Molds case that section 15a(3) applies only to modes of transportation subject to the Act, which would exclude exempt water carriers, but that such exempt carriers are not ruled out of the protection of the Act, as under the National Transportation Policy; and that notice be given to the Lake Carriers case against the United States and ICC, decided in 1975 (after the basic decision in the instant case) which is very close on the facts to the present case and in which the Court overruled the Commission and decided to protect the water carriers.

The Courts Have Uniformly Required that the Commission Recognize and Preserve the Inherent Advantages of Each Mode of Transportation, Unregulated as Well as Regulated

The requirement of recognizing and preserving the inherent advantages of each mode of transportation is part of the National Transportation Policy. The cases, therefore, have uniformly recognized this requirement since 1940. The leading Court and Commission decisions demonstrate that this requirement was met. On a case by case basis the examination of the inherent advantages of each transportation mode produced results sometimes favorable and sometimes unfavorable to the railroad. Similarly, the inherent advantages of exempt carriers were recognized and preserved when it was appropriate

to do so. With the enactment of section 15a(3) the reference in that legislation to the National Transportation Policy coupled with other statutory requirements resulted in some changed emphasis in the cases. It did not, however, alter the underlying and fundamental obligation that the inherent advantages of each mode must be recognized and preserved.

In _Interstate Commerce Commission v. Mechling_, 330 U.S. 567 (1947) there was competition for grain traffic and an all-rail through-rate was created to defeat a barge-rail rate that was inherently lower. The Court rejected the railroad's scheme and maintained that the inherent advantage of low cost barge rate must be preserved for the shipper. In reaching this conclusion, the Supreme Court analyzed the Transportation Act of 1940 which extended coverage to water carriers and it examined the Congressional intent involved, saying:

> "It is therefore not within the province of the Commission to adjust rates, either to equalize the transportation cost of barge shippers with that of shippers who do not have access to barge service or to protect the traffic of railroads from barge competition. For Congress left the Commission no discretionary power to approve any type of rates which would reduce the 'inherent advantage' of barge transportation in whole or in part."

In another pre-1958 case the Supreme Court in _Dixie Carriers, Inc. v. United States_, 351 U.S. 56 (1956) the Court reaffirmed the _Mechling_ doctrine. Here the railroad established a lower joint rate to defeat a combination all-rail rate and a barge-rail rate based upon a combination of rates including the lower cost barge rate. With the refusal of the railroad to establish a joint rail-barge rate, the water carriers complained. The Court said:

> "The policy is to preserve all the 'inherent advantages' of water carriers. That means that a joint barge-rail rate must be established when it appears, as here, that a joint rail rate discriminates against the water carriers. Otherwise, a manipulated rate structure will take the business from the water carriers."

These two cases involved manipulations of rate structures to defeat a lower cost competing mode of transportation. This was disallowed on the basis of our National Transportation Policy which required even handed administration in looking to the inherent advantages of the competing modes.

The post-1958 cases reflect the added difficulties the Interstate Commerce Commission encountered in these intermodal rate controversies in balancing the new section 15a(3) considerations coupled with a vague understanding in favor of greater competition.

Gasoline and Fuel Oil, Friendship, North Carolina to Virginia and West Virginia, 305 ICC 673 (1959) involved a case where the railroad was permitted to maintain a rate below that of a motor carrier because the railroad was the low cost carrier. To the same effect, Sugar to Ohio River Crossings, 308 ICC 167 (1959) where a water carrier was not the low cost mode. In the next year, however, the Commission veered away from its line of approving rates for the low cost mode so long as they were compensatory. In Tobacco from North Carolina to Central Territory, 309 ICC 347 (1960) the Commission denied the lower, compensatory rates in an effort to avert a rate war. There the Commission said:

> "It has been urged in several proceedings before this Commission in which section 15a(3) was concerned, and is implied here, that where proposed reduced rates are on a compensatory level, especially where they are above full cost, they should be permitted to take effect, regardless of the net revenue effect upon the proponents thereof or upon carriers generally. We believe that such a viewpoint, especially with respect to high-grade traffic, is too narrow and out of harmony with the national transportation policy. Followed to its logical conclusion, it would gradually and inevitably result in a leveling downward of the rates generally on high-grade, heavy-volume traffic, from which most carrier profits are derived, to a point where they would cease to yield more than out-of-pocket cost. The effect would be to unnecessarily dissipate much needed revenue that now enables carriers generally to operate profitably, and the rail

carriers in particular to defray deficits which ensue from passenger-train and less-than-carload services and from the transportation of many commodities, including certain farm products, which do not move freely at rates yielding full cost."

In Arrow Transportation Co. v. United States, 176 F.Supp. 411 (Dist. Ct. N.D. Ala. 1959) affirmed 361 U.S. 353 (1960) the controversy involved ex-barge rates which permitted grain to move over the Tennessee River and by rail beyond. The railroads charged their full rates for the transshipment by rail of the ex-barge grain. More favorable treatment was given ex-rail grain transshipped from those ports, and also to the ex-rail grain transshipped from the competing port of Memphis. The Court disallowed the rate under section 3(4) which prohibits discriminatory rates. In doing this the Court said:

> "We construe the Supreme Court decisions in Mechling and Dixie as making unlawful any rate-making device which deprives barge transportation of its rightful place in the National transportation system or which deprives shippers of any part of the economies resulting from the use of barge transportation. We hold, therefore, that the Commission cannot lawfully approve any system of ex-barge rates on grain which deprives shippers of any of the savings of the inbound barge transportation but must prescribe ex-barge rates which will fully preserve the inherent advantages of such barge transportation. (emphasis added)

Here the railroad tried to keep the water carriers of grain off the Tennessee River by refusing the lower rail rate to ex-barge shippers. In the case under consideration the railroad is seeking to drive the water carriers of grain off the Great Lakes by denying the ex-water shippers proportional rail rates that will preserve the inherent advantages of water traffic.

In the succeeding cases the inherent advantage under consideration in the intermodal rate controversies involved the measure of comparative costs, either the out-of-pocket costs or the fully distributed costs. Although these issues of comparative cost are not precisely involved in the instant case, these decisions, particularly those rendered by the United States Supreme Court, are relevant primarily because of the underlying reasoning concerning regulation of intermodal rate competition.

In Interstate Commerce Commission v. New York, New Haven & Hartford Railroad Company, 372 U.S. 744 (1963) equal rates were proposed and there were three competing transportation services: a motor carrier-barge-motor carrier; a trailer on flat cars (TOFC); and motor carrier-rail-motor carrier. The TOFC service was the most expensive, but offered greater service in terms of speed of delivery.

Some of the rail rates were above fully distributed costs while others were above out-of-pocket costs. The Commission made no determination of inherent cost advantages. Instead, it concluded that equal rates would prove destructive of competition and all the traffic would shift to TOFC. The Commission ordered the addition of 6% differential to the rail rate to avert erosion of coastwise navigation needed for national defense. The Commission relied upon its responsibilities under the National Transportation Policy.

On appeal the Supreme Court viewed this device as artificial as did the lower court. It indicated the Commission should give more consideration to the specific wording of section 15a(3) rather than the wording of the National Transportation Policy when reviewing such rate proposals. Competitive rates were not to be denied unless they failed to cover costs or "threatened the existence of a transportation service that is uniquely capable of filling a transcendent national defense or other need". Then the Court said:

> "If there is one fact that standsout in bold relief in the legislative history of Sec. 15a(3), it is that Congress did not regard the setting of a rate at a particular level as constituting an unfair or destructive competitive practice simply because that rate would divert some or all of the traffic from a competing mode....If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own

> revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service."

The Court avoided any definition of the proper cost basis as a means of determining the "inherent advantage" and referred the matter back to the Commission saying:

> "It is not for us to make this determination at this stage, or to decide in advance precisely how either carrier's inherent advantages should be measured or protected. It may be, for example, that neither a comparison of 'out-of-pocket' nor a comparison of 'fully-distributed' costs as those terms are defined by the Commission, is the appropriate method of deciding which of two competing modes has the cost advantages on a given movement."

The <u>New Haven</u> case illustrates the difficult choices that exist at the Commission level. If the rates were viewed from an economic perspective there would have been arguable justification for allowing them. To do so the Commission would have to balance off the requirements of the National Transportation Policy directive. It is unlikely the Commission could satisfy everyone in an intermodal rate case against this background of law.

The Supreme Court decision in the <u>New Haven</u> case was to be interpreted to permit the railroads greater freedom in rate competition. Thereafter, the ICC considered the <u>Southern Grain</u> case, under the title <u>Grain in Multiple Car</u>

Shipments - River Crossings to the South, 321 ICC 582 (1963). The railroad proposed a substantially reduced rate on grain to certain areas predicated upon new technology and reduced services. The rates were based upon out-of-pocket costs and did not purport to cover the fully allocated costs applicable. The railroad was competing with unregulated motor carriers. The Commission did not approve the low rates proposed (66 2/3 percent below the existing rates); instead, the Commission approved slightly higher rates (56 percent below the existing rates). Both the proposed rate and the approved rates were below the fully allocated costs. The justification for these low level rates was that the unregulated motor carriers were successfully capturing rail traffic.

Although the New Haven case had not authorized rates at a level below fully allocated costs, it had urged that carriers be allowed to compete for traffic. Here the Commission evidenced a concern to protect the railroad from the unregulated motor carriers who had been gaining an increasing share of the traffic. Certain aspects of this case should be pointed out: the railroad's rate proposal was defensive in that it sought an instrument of competition

against the unregulated carrier; second, the railroad based its proposal upon new technology and reduced service and the Commission was willing to go along with these efforts, even on a low cost basis.

The _Ingot Molds_ case, _American Commercial Lines, Inc. v. Louisville & Nashville Railroad Co._, 392 U.S. 571 (1968) set the stage for what many speculated could have been the ultimate decision in this line of cases. Here the movement of ingot molds from Pittsburgh to Steelton, Kentucky had been almost exclusively by combination barge-truck service with an overall charge of $5.11 per ton. The railroad lowered its rate from $11.86 to $5.11 to compete and the barge and truck lines protested. The rail rate, it was found, was below its fully distributed costs of $7.59 but above its out-of-pocket costs of $4.59. The fully distributed cost to the barge-truck service was $5.19 and the out-of-pocket costs were approximately the same as their fully distributed costs. If the rates were to be kept even it was clear that all traffic would go to the railroad. The Commission disallowed the railroad rate on the basis that out-of-pocket costs was not the basis upon which inherent advantages should be determined. It concluded that section 15a(3) required that fully distributed costs

should be the basis for comparison in accordance with Congressional intent. The Commission concluded that if this rate was allowed the railroads would undercut the barge-truck combination and force them to go below their fully distributed costs to retain the traffic.

The District Court concluded the true basis for comparison was out-of-pocket costs and the railroad's rate reduction should be permitted so long as it was compensatory. Further, the court held the Commission had failed to articulate its reasons for deciding that the proper way of determining which mode was more efficient; i.e., the fully distributed costs rather than out-of-pocket costs.

The Supreme Court noted that the term "inherent advantage" is nowhere spelled out in the statute and indicated, relying upon the New Haven case, that it may be that neither comparison, out-of-pocket nor fully distributed costs, is the appropriate method. Then it said:

> "...the Commission could, after due consideration, decide that some other measure of comparative costs might be more satisfactory in situations involving intermodal competition than the one it had traditionally utilized. That is a far cry from saying that it must." (emphasis the courts)

Then the Court concluded:

> "Nothing we say here should be taken as expressing any view as to the extent that Sec. 15a(3) constitutes a categorical command to the I.C.C. to use fully distributed costs as the only measure of inherent advantage in intermodal rate controversies. As was stated in the <u>New Haven</u> case, it 'may be' that after due consideration another method of costing will prove to be preferable in such situations as the present one. All we hold here is that the initial determination of that question is for the Commission."

A further question in this case was whether or not the ICC had adequately articulated its reasons for disallowing the proposed rate. In that connection, the Supreme Court made the following statement:

> "the District Court also objected to the failure of the Commission to explain why it permitted out-of-pocket rate-making where the competing carrier was unregulated and not where the competition was regulated. <u>The short answer to this is that Section 15a(3) by its own terms applies only to 'modes of transportation subject to this act', which by definition means regulated carriers</u>. As a result, any arbitrariness that may flow from the distinction recognized by the Commission between regulated and unregulated carriers in situations of intermodal competition is the creation of Congress, not the Commission." (emphasis added)

This holding by the Supreme Court confirms the view of this petitioner that section 15a(3) does not apply to exempt carriers. It may be that this is the first statement to this effect by the Supreme Court of the United States but it

reflects the views held by the Commission over the years, in that unregulated carriers are treated differently. In this connection the Commission has evidenced a strong tendency to extend considerable leeway to regulated carriers in meeting competition of unregulated carriers.* In the Southern Grain case, supra, the Commission approved a low rail rate to permit the railroad to counter the successful competition of unregulated motor carriers. More often than not, however, it has been the courts that had to intervene to protect the unregulated carrier from the predatory acts of the regulated carriers, usually a railroad. See Arrow Transportation Co. v. United States, supra.

The issue was drawn in a recent case decided before the District Court of the Northern District of Ohio. While it was still before the Commission one authority referred to it as a case "which represents the most serious in a long

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* See Coal from Southern Mines to Tampa and Sutton, Florida, 318 ICC 371 where proposed rail rates were approved to meet unregulated water competition even though the rail rates did not cover out-of-pocket costs. In Canned or Preserved Foodstuffs - Pacific Coast to Gulf, 314 ICC 585 sharply reduced rail rates were approved to meet competition of unregulated water carrier. Cf. ICC v. New York, New Haven & Hartford R. Co., 372 U.S. 744 (1963) discussed supra.

history of rail attacks on waterborne traffic".*

In Lake Carrier's Association v. United States, 399 F.Supp. 386 (Dist. Ct. No. Dist. of Ohio, 1975) coal shipments by rail from the mines to ports on Lake Erie were thereafter transshipped by water on barges by unregulated lake carriers to utility companies located in Michigan. The railroads offered an all rail unit train rate that was lower than the rail-water costs to the same destination. No comparable unit train rate was available from the coal mines to the Lake Erie ports. The Commission found the rail rates reasonable and permitted them to stand. The District Court disagreed. It reviewed Congressional intent as expressed in the Transportation Act and concluded that it was in the public interest to protect the water carriers. There is no suggestion in the decision that the unregulated water carriers are not entitled to the protection against the discriminatory rate action by the rail carrier.

The case under consideration bears strong resemblance to the Lake Carrier case, supra, and it confirms that the unregulated carriers are entitled to the protection of the

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* ICC Jurisdiction of Great Lakes Rail-Water Competition, Arthur E. Miller, 19 Cleveland St. L.R. 407 (May, 1970).

Commission and the Courts from unlawful and discriminatory actions by a regulated carrier.

It is Error to Hold that Exempt
Lake Carriers are not Entitled to
Protection of Section 3(4) and
are not a Connecting Carrier
<u>Within the Meaning of this Section</u>

The Commission decision avoided discussing the section 3(4) issue on the merits and concluded, as the heading indicates, (1) that the exempt lake carriers are not entitled to the protection of the section, and (2) the same lake carriers are not connecting carriers within the meaning of the section because "The proposed all-rail route passes well south of Buffalo and Erie does not extend unequal treatment at Buffalo as between carriers."

Taking these issues in order, the first one fails in the light of the decisions such as <u>ICC</u> <u>v</u>. <u>Mechling</u>, <u>supra</u>, <u>Dixie</u> <u>Carriers</u>, <u>Inc</u>. <u>v</u>. <u>United</u> <u>States</u>, <u>supra</u>, and <u>Arrow</u> <u>Transportation</u> <u>Co</u>. <u>v</u>. <u>United</u> <u>States</u>, <u>supra</u>. In <u>American</u> <u>Barge</u> <u>Line</u> <u>Co</u>. <u>v</u>. <u>Alabama</u> <u>G.S.R</u>. <u>Co</u>., 300 ICC 167, ex-barge grain was denied proportional rates for the same route and the same destination where such rates were available to all

rail shippers. The barge line was exempt from regulation. The Commission held the failure to maintain identical rates for the ex-rail and ex-barge traffic violated section 3(4), relying upon the decisions in Mechling and Dixie Carriers. One Commissioner dissented on the ground that the unregulated carrier was outside the protection of section 3(4).

The next contention in the Commission's decision is that the exempt lake carriers are not connecting carriers within the meaning of section 3(4) insofar as there is no physical connection at a given point, presumably Buffalo. This issue has been put to rest for many years. In Atlantic Coast Line R. Co. v. United States, 284 U.S. 288, Justice Brandeis, speaking for a unanimous court, said: "There is no warrant for limiting the meaning of 'connecting lines' to those having direct physical connection....The term is commonly used as referring to all the lines making up a through route." Id., at 293. In Western Pacific R. Co. v. United States, 382 U S. 237 (1965) this view was reaffirmed and a conclusion was reached that would not support the Commission's current view on "connecting carrier".

Having survived the procedural hurdles set up by the Commission, the lake carriers are entitled to have their

arguments under section 3(4) considered on the merits.

The lake carriers maintain the railroads violate that section in that the water carriers were subjected to discriminatory rates. The Duluth-Superior unit train rate to Martins Creek involves an improper preference; and the railroads further violated the section in refusing to offer the ex-water grain a proportional rate from Buffalo east that is comparable to the unit train rate.

The similarity of these facts to those involved in the Lake Carrier's Association v. United States, supra, is striking. The ex-barge coal at the Lake Erie ports was denied the advantage of a unit train rate from the coal mines to Lake Erie when the railroad provided a lower cost unit train rate from the mines to the Michigan destination. The District Court properly held this was discrimination against the exempt water carrier.

The Ingot Molds decision in the Supreme Court, discussed supra, includes positive views relevant to the position of the lake carriers in this case. In that case, according to the Court, the railroad offered certain economic arguments to justify its practices of discrimination and preferential rates (needless to say, section 3(4) was not

mentioned in this connection). The argument was not favorably received by the Supreme Court, the opinion comments: "The economists then go on to argue, in effect, what is good for the railroads is good for the country." The railroad claims, according to the Court, that it should be permitted to selectively price its services on a low rate basis so the shipper will benefit from that low rate and the newly acquired traffic revenue makes some contribution to the railroad's overhead. Other shippers, it is claimed, also benefit because the new traffic begins to pay a portion of this overhead, previously charged entirely to them. The overall benefit to shippers, it is claimed, outweighs the harm caused to the other mode of trnasportation.

Obviously, this railroad logic did not impress the Supreme Court who pointed out that the sole reason for initiating the rate reductions was the existence of a competing mode. If that competing mode is driven out of business because it is unable to match the low rates offered by the railroad, then there could be no justification for maintaining the low rates. This is so because the railroad could then raise these rates and initiate low rates on the same basis in a different competitive area. Eventually the

railroad would be able to eliminate all competition. At the same time it could reprice all services to cover its overhead costs and in that way remove customer discrimination wherever it exists. When this is done certain shippers would have permanently lost the low cost benefits that existed under competitive circumstances when the competing mode was still in existence. American Commercial Lines, Inc. at U.S. 586-589.

It seems clear the same railroad theory related to ingot molds is at work here in connection with the grain to Buffalo and Martins Creek, and it has made a favorable impression on the Commission. To the extent the Commission opinion avoided consideration of the section 3(4) and permitted the railroads to engage in discriminatory and preferential rates it was curtailing competition. The Commission went out of its way to emphasize that the Erie's poor financial condition was a factor in its consideration. It considered the proposed rates would provide a needed step toward financial vigor. It went so far as to point out that the Commission has an obligation to promote efficient service and foster sound economic conditions in transportation and, irony of ironies, the National Transportation Policy does not justify the conclusion that the proposed rates are contrary to that policy.

The argument could not be better stated by the same railroad economists in the <u>Ingot Molds</u> case. One is prompted to answer this argument, with a degree of justified sarcasm, if we have any more bankruptcies of eastern railroads, the water carriers on the Great Lakes may go broke.

One must step back and consider the import of the Commission's conclusion that the exempt water carriers are not entitled to protection under the section 3(4). It is novel indeed. One of the major reasons for establishing the Interstate Commerce Commission in 1887 was the desire to prohibit rate discrimination. During the early years of regulation the courts applied strict antitrust standards to the railroads. A series of landmark cases from the Supreme Court applied the Sherman Act to railroads. Congress eventually changed this and determined that, as a matter of public policy, the prohibition of rate discrimination was more important than the preservation of competition in the transportation industry. The requirement that the rate structure must be fair to everyone was embodied in section 3. In a sense the Commission pulls the rug out and leaves the Great Lakes water carriers vulnerable to the discriminatory and predatory practices of railroads who may act with immunity and impunity.

When we consider this new concept in its proper perspective it seems clear that it cannot stand. The responsibility to regulate in an industry such as the transportation industry carries with it the obligation to maintain a standard of fairness and impartiality. That is the express terms of the National Transportation Policy; it is the import of our laws and the decisions of the Courts and Commission who now denies it. The concept has a further defect, it violates common sense.

Part IV

Conclusion

Conclusion

The proposed rail rates do not recognize and preserve the inherent advantages of the Great Lakes water carriers and do not promote economical and efficient service among the several carriers. To the contrary, said rates constitute unfair and destructive competitive practices against said water carriers - all in violation of the National Transportation Policy.

WHEREFORE, Intervenor requests this Court find that the proposed rail rates are unlawful.

Respectfully submitted,

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Part V

Addendum

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Statutes

National Transportation Policy
(49 USC preceding §1)

It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical, and efficient service and foster sound economic conditions in transportation and among the serveral carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discriminations, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions; - all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense. All of the provisions of this Act shall be administered and enforced with a view to carrying out the above declaration of policy.

49 USC §3(4) (Interchange of Traffic)

All carriers subject to the provisions of this part shall, according to their respective powers, afford all reasonable, proper and equal facilities for the interchange of traffic between their respective lines and connecting lines and for the receiving, forwarding, and delivery of passengers or property to and from connecting lines; and shall not discriminate in their rates, fares, and charges between connecting lines, or unduly prejudice any connecting line in the distribution of traffic that is not specifically routed by the shipper. As used in this paragraph the term "connecting line" means the connecting line of any carrier subject to the provisions of this part or any common carrier by water subject to part III.

49 USC §15a(1)-(3) (Rule of Rate-making)

(1) When used in this section, the term "rates" means rates, fares, and charges, and all classifications, regulations and practices relating thereto.

(2) In the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed; to the need in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service, and to the need of revenues sufficient to enable the carriers under honest, economical, and efficient management to provide such service.

(3) In a proceeding involving competition between carriers or different modes of transportation subject to this Act, the Commission, in determining whether a rate is lower than a reasonable minimum rate, shall consider the facts and circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable. Rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation, giving due consideration to the objectives of the national transportation policy declared in this Act.

49 USC §142 (National Policy on Water Transportation Under Interstate Commerce Act)

It is hereby declared to be the policy of Congress to promote, encourage, and develop water transportation, service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation.

It shall be the duty of the Secretary of War [Commerce], with the object of promoting, encouraging, and developing inland waterway transportation facilities in connection with the commerce of the United States, to investigate the appropriate types of boats suitable for different classes of such waterways; to investigate the subject of water terminals, both for inland waterway traffic and for through traffic by water and rail, including the necessary docks, warehouses, apparatus, equipment, and appliances in connection therewith, and also railroad spurs, and switches connecting with such terminals, with a view to devising the types most appropriate for different locations, and for the more expeditious and economical transfer or interchange of passengers or property between carriers by water and carriers by rail; to advise with communities, cities, and towns regarding the appropriate location of such terminals, and to cooperate with them in the preparation of plans for suitable terminal facilities; to investigate the existing status of water transportation upon the different inland waterways of the country, with a view to determining whether such waterways are being utilized to the extent they are meeting the demands of traffic, and whether the water carriers utilizing such waterways are interchanging traffic with the railroads; and to investigate any other matter that may tend to promote and encourage inland water transportation. It shall also be the province and duty of the

Secretary of War [Commerce] to compile, publish, and distribute, from time to time, such useful statistics, data, and information concerning transportation on inland waterways as he may deem to be of value to the commercial interests of the country.

The words "inland waterway" as used in this section shall be construed to include the Great Lakes.

49 USC §903(b) (Also known as section 303(b) of the Interstate Commerce Act)(Bulk Commodities Exemption)

> Nothing in this part shall apply to the transportation by a water carrier of commodities in bulk. This subsection shall apply only in the case of commodities in bulk which are (in accordance with existing custom of the trade in the handling and transportation of such commodities as of June 1, 1939) loaded and carried without wrappers or containers and received and delivered by the carrier without transportation mark or count. This subsection shall not apply to transportation subject, at the time this part takes effect, to provisions of the Intercoastal Shipping Act, 1933, as amended.

Certificate of Service

I hereby certify that I have this 10th day of June, 1976, served two (2) copies of the foregoing Brief via first-class mail, postage prepaid, to counsel for each party of record.

Arthur N. Chagaris

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